State of Israel
Ministry of Finance

Pros and Cons of Retail Bonds
An issuer’s Viewpoint

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OECD Global Forum
Amsterdam, December 6, 2006
Advantages of Retail Issuance

1. Alternative Source of Funding?
2. Cheaper Source of Funding?
3. Access to Small Investors?
4. Custodian/Bank/Fund – Dis-intermediation?
5. Less Volatile?
Disadvantages of Retail Issuance

1. Costly, Complicated Administration
2. Market Fragmentation
3. Competition with Private Sector
4. Non Tradable
5. Contrary to Wholesale Trends – PDs, MTS etc.
Issues - Dilemmas

1. Alternative Source of Funding?

Q: Will we get new money (How much?) or is it just substitution / “cannibalization” of existing channels?
2. Cheaper Source of funding?

Q: Will we be able to get better prices than our “regular” bonds? (Especially if non-tradable)

Will it still be cheaper after administrative costs?
3. Access to Small Investors

Q: is there something that the government should do directly or, like many other service, should it be out-sourced to intermediaries which are more efficient / flexible?

If Yes – What is the real potential?

Is it real or just PR?
Issues - Dilemmas

4. How Would The Banks / Funds React?

How Would PDs React?

“Retaliation” …
Issues - Dilemmas

5. Reduced Volatility

Is secondary market volatility important to issuer?

“Fair value” is an important market signal

Not transparent
6. Costs

Whether government does it directly or through an agent (post office) – Retail always costly!

Should be subsidized?
Who pays for it?
Is it fully accounted for?
7. Market Fragmentation

Contrary to main trend of achieving large, liquid bonds

Taking away liquidity from PDs, MTS etc.
Tradable vs. Non Tradable (or Both)

1. Tradable Requires market interface i.e. a broker / dealer

2. If uni-directional (i.e. just sell for buy and hold) not really tradable

3. Non tradable is inferior to tradable-less efficient, less transparent
Therefore, only worth while if “our” (Govt.) non-tradable replaces “their” non-tradable (bank deposits) or if market is non-competitive (retail pays too high to intermediaries).

But even if competition is the answer should the issuer be a competitor?
Retail debt in Israel

1. Domestic tradable retail accounts held directly with the issuer.

2. External retail program – the Israel Bonds Organization.
Domestic Retail

Any investor can transfer regular tradable bonds and T-bills to a retail account at the Ministry of Finance/Central bank.

The Ministry/BOI manages the account for free!

As of 1.4.2006, the Ministry of Finance imposed a 1% annual fee – all accounts closed.

Central bank which manages T-bills continues with no-cost policy!
Our Rationale

1. We are not brokers

2. Our limited resources are better utilized and more needed for the wholesale mkt. reforms etc.

3. The market is efficient and competitive - Low prices for custody, brokerage services
The Israel Bonds Organization

Apprx. Us$ billion/year
## Characteristics of Bonds Issued by the Bonds Organization

<table>
<thead>
<tr>
<th>Bond type</th>
<th>Interest</th>
<th>payment</th>
<th>Maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jubilee 2 Years</td>
<td>TB2y + spread</td>
<td>Every six months</td>
<td>2</td>
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<tr>
<td>Jubilee 5 Years</td>
<td>TB5y + spread</td>
<td>Every six months</td>
<td>5</td>
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<tr>
<td>Jubilee 7 Years</td>
<td>TB7y + spread</td>
<td>Every six months</td>
<td>7</td>
</tr>
<tr>
<td>Jubilee 10 Years</td>
<td>TB10y + spread</td>
<td>Every six months</td>
<td>10</td>
</tr>
<tr>
<td>2-Year Savings Bond</td>
<td>Strip2y + spread</td>
<td>End of period</td>
<td>2</td>
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<tr>
<td>Mazel Tov Savings Bond</td>
<td>Strip5y + spread</td>
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<td>Canadian Jubilee2 Years</td>
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<tr>
<td>2-Year Euro Savings Bond</td>
<td>German Strip + spread</td>
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<td>German Strip + spread</td>
<td>End of period</td>
<td>10</td>
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<tr>
<td>10-Year Libor</td>
<td>Libor + spread</td>
<td>Every six months</td>
<td>10</td>
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<tr>
<td>4-Year Libor</td>
<td>Libor + spread</td>
<td>Every six months</td>
<td>4</td>
</tr>
<tr>
<td>7 Year Euro</td>
<td>Euribor + spread</td>
<td>Every six months</td>
<td>7</td>
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<td>Development 4%</td>
<td></td>
<td>End of period</td>
<td>15</td>
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<tr>
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<td>End of period</td>
<td>15</td>
</tr>
<tr>
<td>Zero Coupon</td>
<td>Strip10y + spread</td>
<td>End of period</td>
<td>10</td>
</tr>
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</table>
1. Usually not cheaper than our tradable bonds (55 bps vs. 53)

2. High administrative costs

3. Not liquid, transparent

4. Maintained for “strategic” considerations
Conclusions

Israel’s experience with retail instruments and accounts doesn’t encourage setting up new retail programs.

Can support the maintenance of existing programs/frameworks but these can and should be downsized, streamlined.
As financial intermediation is usually a private sector activity, govt. should intervene principally if a market failure exists (i.e. lack of a competition, excessive commissions etc).
Conclusions cont.

Even so – should Govt. compete directly (i.e. set-up and manage retail framework) or alternatively use its power/influence to encourage others to compete (invite foreign banks, improve legislation, anti-trust etc.).
THANK YOU